

Central Intelligence Agency



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## DIRECTORATE OF INTELLIGENCE

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## Hong Kong: A Settlement Is Reached

Summary

The initialing of a Sino-British accord on Hong Kong later this month and its formal ratification by next June now seem all but certain. Although some groups in Hong Kong--and possibly within the British Conservative Party--are likely to attack the agreement as too vague, we do not expect this opposition to derail the ratification process. Indeed, the reaction in Hong Kong is likely to be a mixture of relief and resignation. [redacted]

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Once the accord is ratified both sides will turn to the lengthy process of working out the details for the eventual transfer of authority over Hong Kong to China in 1997. Beijing's key objectives during this transition period will be to expand its narrow base of support and influence in the colony while somehow maintaining economic and social stability. By doing so, Beijing hopes to induce Taiwan to reconsider its refusal to discuss reunification. [redacted]

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This memorandum was prepared by [redacted] China Division, Office of East Asian Analysis. It was coordinated with EURA. Comments and questions are welcome and should be addressed to Chief, OEA/China/Foreign Affairs Branch, [redacted]

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Many senior Chinese officials, however, remain suspicious of British intentions and are determined to prevent British authorities from using their continued control during the interim to undercut Chinese interests. If Beijing interferes heavily-handedly to block such machinations--real and imagined--it risks triggering the very flight of capital and talent it hopes to avoid. The next few years should provide a clearer indication of whether the Chinese can adroitly extend their influence without undermining what little public confidence exists in China's promises to leave Hong Kong's economic and social systems intact. [REDACTED]

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### The Expected Agreement

The agreement, or "joint declaration" as it will be called, is expected to consist mainly of a brief set of principles. It will acknowledge China's assumption of sovereignty and administration over Hong Kong in 1997 and will outline China's plan for maintaining Hong Kong's existing social and economic systems and autonomy for 50 years after that. Several annexes will lay out the transition arrangements and the rights of Hong Kong's government and residents after 1997. These annexes, which will cover most of the provisions that China plans to incorporate into its basic law for Hong Kong, will be concluded through an exchange of diplomatic notes. [REDACTED]

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The key elements of the joint declaration already agreed upon include:

- Hong Kong's existing British legal system will be preserved with final judicial appeal rights vested in a high court in Hong Kong, instead of London or Beijing.
- All land leases, including those in the New Territories, will be renewable through 2047 and a Sino-British commission on land will be set up shortly to monitor transactions.
- The power to make laws will remain with the Legislative Council.
- Hong Kong's economy will remain autonomous. The local dollar will continue to be convertible and capital movement and trade will be unrestricted. Hong Kong will remain a separate customs territory, will retain its membership in international organizations such as GATT, and will remain a free port.
- Residents will have the right to move in and out of Hong Kong freely. British-Hong Kong passports will

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remain in use after 1997, but holders will not be able to pass this right on to the next generation.

- Civil servants will be retained, although foreigners, including the British, will be allowed to serve only below the ministerial level.

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The complicated details of the transition will be left for a joint liaison group to negotiate. For example, the British expect the liaison group to deal initially with arrangements for Hong Kong's continued participation in several hundred international agreements and organizations.

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A few points will remain unresolved. Of these the most significant is how Hong Kong's chief executive and his deputy will be chosen after 1997. London favors direct popular elections, seeing that as a way to help safeguard Hong Kong's autonomy. Beijing, however, is determined to retain a large voice in the choice of the governor. In mid-September, the two sides did agree that Hong Kong's chief executive will be responsible to an elected legislature.

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#### Ratification

Despite these gaps, Prime Minister Thatcher is undoubtedly pleased at the prospect of putting the Hong Kong question in large measure behind her. Thatcher seems confident that sufficient concessions have been obtained to sell the accord to Parliament and the people of Hong Kong. The British believed earlier that they required a commitment from China not only that Hong Kong would be granted autonomy, but that the accord would have the status of a legally binding international agreement. Foreign Secretary Howe publicly asserted that he got those assurances during his visit to Beijing in July, and both he and Thatcher will probably emphasize the binding aspects of the accord in the Parliamentary debate.

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In addition, the Chinese agreed to allow the joint liaison group to remain in existence until the year 2000, giving the British at least a symbolic official presence in Hong Kong after it reverts to Chinese sovereignty. In turn, the British acquiesced to China's insistence that the liaison group be based

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<sup>1</sup> Beijing first proposed establishing a joint liaison group back in April and has never made its functions clear. We believe China wants to use the group primarily as a watchdog agency to protect Beijing's interests in Hong Kong.

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[redacted]

in Hong Kong beginning in 1988 on the condition that it not have any administrative authority.<sup>2</sup> Chinese insistence on this point suggests that Beijing intends to use this group as a vehicle for exerting influence over British policy. [redacted]

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Once the accord is initialed, the British Parliament will take it up when it reconvenes in late October. In the meantime, the British have promised to set up an "assessment office" in Hong Kong to canvass public reaction to the agreement. Unless unexpectedly strong opposition erupts in Hong Kong (or within the right wing of the British Conservative Party), the Thatcher government expects the accord to be ratified in time for China and the United Kingdom to hold a signing ceremony by next summer. [redacted]

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We expect the reaction in Hong Kong to be mixed. Some interest groups are likely to be strongly critical of the vagueness of the guarantees China has agreed to. But many, perhaps the vast majority, probably will be relieved that Hong Kong's future has been somewhat clarified, or will be resigned to the fact that they are powerless to change the outcome. Even if groups in Hong Kong raise strong objections, we believe the Thatcher government would be unwilling to reopen the talks and press for changes in the accord. Howe made that very clear at a press conference at the conclusion of his last visit to China. British officials will instead hold out the prospect that the goodwill accrued from the agreement will permit issues to be resolved through informal talks. [redacted]

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Once the Chinese leadership signs off on the agreement, ratification by the National People's Congress or its Standing Committee is purely pro forma. Indeed, the Chinese probably will celebrate the initialing of the accord on 1 October, as part of their larger National Day celebrations. [redacted]

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### Beijing's Goals During the Transition

Having obtained Britain's acquiescence to Chinese sovereignty and its agreement to relinquish control over Hong Kong, Beijing will undoubtedly seek to develop more concrete influence over the territory's affairs during the transition period. And Beijing will be trying to expand its narrow base of

<sup>2</sup> The UK opposed having the joint liaison group based in Hong Kong during the transition period fearing that it would undercut their authority. A compromise was struck during Howe's July visit so that the group will meet alternately in Hong Kong, London and Beijing until 1988 when it will be based in Hong Kong. [redacted]

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popular support as well as its influence within the executive and administrative structure with the aim of gaining a strong behind-the-scenes say in policy matters. [REDACTED]

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It is very important to China that Hong Kong's economy continue to prosper because of its role in China's own economic modernization drive. Not only does China earn about one-third of its foreign exchange there, but the territory also is an important source of financial and technical assistance. The Chinese may also calculate that some foreign companies' decisions to invest in China will be influenced by how Beijing deals with the territory. [REDACTED]

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Beijing probably believes, moreover, that a smooth, orderly transition will strengthen its ability to press Taiwan on reunification. Buoyed by their success in regaining sovereignty during Hong Kong, the Chinese may well make new overtures to Taipei over the next year or so. At a minimum, they are likely to encourage Taiwan to maintain its economic ties with the territory and perhaps seek to establish or expand their contacts with Kuomintang supporters in the colony as a back channel to Taipei. [REDACTED]

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#### Expanding Chinese Influence

To build public support and confidence in China's takeover we expect Beijing to:

- Solicit local views on the content of the Basic Law, which will spell out the details of how Hong Kong will function as a special administrative region of China after 1997. Next year China plans to set up a drafting committee in Beijing along with a consultative committee in Hong Kong. [REDACTED]
- Cultivate key groups and individuals in the colony by offering them such inducements as positions in a post-1997 administration, trade deals with China, Bank of China loans, or other forms of support. [REDACTED]
- Make selected, well-publicized investments in Hong Kong to bolster confidence within the Hong Kong business community. For example, a subsidiary of the Bank of China recently provided China's first loan to a Hong Kong public utility--\$38 million to expand the local subway system. [REDACTED]
- Refrain--especially at first--from intervening publicly in Hong Kong's internal affairs. China's representatives in the territory, for example, refused a recent request by Hong Kong's American Chamber of Commerce to intervene on the colony's behalf to protest recent US textile restrictions. A senior Chinese official deftly turned the request

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[redacted]

aside by asserting that the defense of Hong Kong's interests still lie with the British and that China did not want to undermine their authority. [redacted]

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- Pay lip service to democratic reforms, while organizing its own slate of candidates to compete for seats on Hong Kong's Executive and Legislative Councils. In June, Deng Xiaoping told Hong Kong delegates to the National People's Congress that they should participate more in the political and economic life of Hong Kong. Deng also advised the delegates to help train personnel who could eventually take over responsibility for Hong Kong's administration beginning in 1997. [redacted]

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- Continue to use propaganda to develop support in Hong Kong. Xinhua issued press guidance in early May instructing its representative in the colony to focus on winning over the masses in Hong Kong who do not support one side or the other. The guidance added that Beijing's media outlets in Hong Kong should continue "the struggle" by reasonable arguments and not hurl abuse. [redacted]

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At the same time, Beijing plans to use its continuing negotiations with the British through the joint liaison group as a key venue for protecting its interests in Hong Kong. [redacted]

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[redacted]

Beijing almost certainly will also seek to influence the selection of officials appointed to key positions in the Executive and Legislative Councils, the bureaucracy, the police, and security apparatus. [redacted]

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Potential Pitfalls

Gaining public confidence will not be easy. Beijing's credibility with the people of Hong Kong has never been high. After all, most of the territory's population is made up of refugees from the PRC and their families. [REDACTED]

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Those that count--the business and professional classes--who have the option of leaving, will be watching to see not only what is contained in the agreement, but probably more importantly whether China lives up to its promises not to tamper with Hong Kong's economic and social systems. The lower classes, which, have fewer or no options, can only hope for the best. [REDACTED]

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Beijing clearly recognizes the importance of gaining and sustaining public confidence in Hong Kong but this does not mean that the Chinese necessarily will prove able to stick to a course of moderation and flexibility. Nationalistic and ideological pressures will be at work in Beijing during the transition period. The best of current intentions notwithstanding, Beijing may not be able to refrain from heavy handed tactics--especially if it comes to believe that the British are attempting to circumvent the spirit of the agreement. [REDACTED]

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Beijing could misstep in several ways:

- By excessively meddling in Hong Kong's administration or economy during the transition. For example, Beijing could try to convert its representatives to the joint liaison group into a shadow government. China's leading economic organizations in Hong Kong, such as the Bank of China and China Resources Company, could also begin putting strong pressure on local businesses to deal primarily with PRC companies.
- By showing signs of reneging on its commitments made to the people of Hong Kong, especially those included in the Sino-British agreement. For example, Beijing would upset the Hong Kong people if it indicated it was going to restrict their right to travel abroad or conduct business with few restraints.

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-- By wrangling with the British over transition arrangements to the point where little if any cooperation is taking place. [REDACTED]

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### Prospects

Much of Hong Kong's future will depend on how its business community reacts to the settlement. We expect Hong Kong's domestic investors (who account for the bulk of total investment) to remain cautious during the next year as they wait to see how the agreement is implemented. They are likely to prefer short term investments which will support the strong economic recovery Hong Kong has been making. Over the longer term the outlook is more uncertain. Inevitable leadership changes in Beijing will raise new concerns about China keeping its commitments to Hong Kong. Even if continuity is maintained in Beijing, Hong Kong's propensity to talk itself into a near-panic state will remain a threat to the territory's future. [REDACTED]

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Pressure for the US to support the Hong Kong settlement is already developing. The British are asking for a statement of support and the Chinese would welcome such an act. With the United States the largest foreign investor in Hong Kong and the colony's largest trading partner, continued economic involvement by US firms will be most welcome. [REDACTED]

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